26-Oct-2016

Sonus Networks, Inc. (SONS)

Q3 2016 Earnings Call

CORPORATE PARTICIPANTS

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

OTHER PARTICIPANTS

Mark D. Kelleher
Analyst, D. A. Davidson & Co.

Ryan Hutchinson
Analyst, Guggenheim Securities LLC

Jess Lubert
Analyst, Wells Fargo Securities LLC

Greg Mesniaeff
Analyst, Drexel Hamilton LLC

Paul Silverstein
Analyst, Cowen and Company, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Third Quarter 2016 Conference Call. During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question- and-answer session. [Operator Instructions] As a reminder, the call is being recorded Wednesday, October 26, 2016.

And I would now ice to turn the call over to Susan Villare, Interim-CFO. Please proceed.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

Thank you, and good morning. Welcome to Sonus Networks' third quarter 2016 financial results conference call. Today's press release and supplementary data have been posted to our IR website at sonus.net and submitted to the SEC. A recording of this call and the transcript will be available on our IR website shortly after this call. During our prepared remarks, we will be referring to a presentation with supporting information. Please take a moment to locate these documents on our IR website.

As shown on slide two, please note that during this call, we will be making forward-looking statements regarding such items as future market opportunities and the company's financial outlook. Actual events or financial results may differ materially from these forward-looking statements and are subject to various risks and uncertainties including, without limitation, economic conditions, market acceptance of our products and services, the timing of customer purchasing decisions, and revenue recognition, difficulties leveraging market opportunities and integrating acquired businesses and the impact of cost containment efforts.

A discussion of these and other factors that may affect our future results is contained in our most recent Form 10 - Q filed with the SEC and in today's earnings release, both of which are available on our website. While we may elect to update or revise forward-looking statements at some point, we specifically disclaim any obligation to do so.

During our call, we will be referring to certain GAAP and non-GAAP financial measures. A reconciliation of the non-GAAP to comparable GAAP financial measure is included in our press release issued today.

Before I hand over the call to Ray, I'd like to provide color on our investor outreach for the fourth quarter of 2016. We will be in Boston for meetings with investors tomorrow, October 27. We will also be attending the Wells Fargo Securities TMT Conference in New York City on November 10, with our formal presentation at 10:30 a.m. Lastly, on November 17 and 18, we will be holding meetings in Chicago and Milwaukee hosted by D.A. Davidson.

We encourage current and potential future investors to reach out to the IR contacts if you would like to schedule a one on one meeting if any of these locations and dates are convenient. Please see our IR website for contact information.

With that, let me turn it over to the President and Chief Executive Officer of Sonus, Ray Dolan.

Raymond P. Dolan

President, Chief Executive Officer & Director, Sonus Networks, Inc.

Thank you, Susan and good morning, to everyone on today's call. Let me explain our framework for today as we've quite a bit of data to share with you. First, we will start off with a review of Q3 for Sonus stand -alone, which was very strong despite a challenging environment. We will also include the small period that we consolidated Taqua after closing the deal on September 26.

Second, we will discuss our outlook for Q4, both for Sonus on a stand-alone basis and for Taqua. Also, given that our Q4 revenue outlook for both Sonus, as well as Taqua are now somewhat lower than our prior views, I'll share our perspective on what is driving those differences based on the challenging environment that I just mentioned.

We plan to share our 2017 outlook on our February call when we announce our Q4 results. While we see another year ahead of us at low single-digit revenue growth, we currently expect the 2017 full year combination of revenue, gross margin and OpenX to lead to another profitable year for Sonus on a non-GAAP basis, with solid cash flow from operations as we continue our focus on supporting our customers through their transition to Cloud - based architectures. Susan will provide all the details and precise numbers in our prepared remarks using the same basic framework we've done in the past.

Also I want to clarify that we plan to provide financial results for both Sonus and Taqua separately, as well as consolidated in Q4 2016. In 2017, we will only provide consolidated results consistent with prior transactions. This level of detail was included in this morning's press release, and since there's a great deal of information, I want to be clear up front regarding how I see our business doing strategically so you can determine the proper context of our results, as well as our outlook from your own point of view.

Okay, let's turn to slide four and get started with the review of our Q3 financial results. As you can see, we had very solid operating and financial performance this past quarter. The combination of revenue, margin and continued expense discipline led to outstanding EPS performance. I couldn't be more pleased with the work of the entire Sonus team that delivered these strong results and their continued commitment to our customers.

For Taqua, the Q3 impact was immaterial to our consolidated financial results. Susan will handle the details behind the $0.01 dilution to our Q3 consolidated results as it rounded up to $0.01 versus down to break even as we had expected.

Turning to slide five, you can see we had a nice balance of enterprise and service provider product revenue. Enterprise accounted for 21% of product revenue in Q3. Our channel grew as well over the course of 2016 and contributed 32% of product revenue in Q3. Our geographic mix was consistent with prior quarters at 70% domestic and 30% international.

Revenue concentration from our top five customers was 41%, down slightly from prior periods. AT&T was the only 10% customer for the quarter, they were in fact 12% of total revenue, or $7.8 million in Q3. I'm also pleased that we continued to see expansion orders from several Tier 1s. While the levels would not trigger a 10% disclosure, these deals were strategic and they included both growth and legacy expansion as we focus on meeting their needs to transform their networks.

Now let's turn to slide six and talk about our outlook for Q4, starting with Sonus on a stand -alone basis. Our prior Q4 implied guidance for Sonus only, excluding Taqua, was $74 million to $78 million, and our current revenue outlook is now in the range of $65 million to $67 million, excluding Taqua. This lower revenue guidance reflects the challenges we're facing, calling the timing of certain deals. In some cases, we have customer consolidation causing a potential pause in spending.

In other cases, we're now swapping competitor's equipment and the operating environments can lead to delays for cut over that extend beyond our standing project timeline. In those cases, where we see potential delays beyond our control, we've adjusted our guidance accordingly. While we have lowered our revenue guidance for Q4, we continue to see solid traction in both service provider and enterprise customers.

We are not aware of any major competitive losses, other than one in Japan, which was against a very strong Japanese-based incumbent for NNI. NNI, or Network-to-Network Interconnect, is the common Asia-Pac term for IP Peering (6:39). We continue to see NNI opportunity in Japan as a solid chance for us in 2017, especially with customers where we have strong established relationships and embedded networks. We also have not forecasted any fourth quarter budget flush. Our outlook reflects management's view of our fourth quarter results knowing what we know today.

As you can see on slide six, we've lowered our outlook on revenue, while we continue to focus on margin expansion and expense controls should still allow us to forecast a solid Q4 non -GAAP EPS performance in the range of $0.09 to $0.12 per share. That Q4 non-GAAP EPS range would lead to a full year non-GAAP EPS of $0.33 to $0.36 per share, coming off our strong non-GAAP EPS performance in Q3 of $0.13. That fiscal year range would imply non-GAAP operating income of 7% to 8% of revenue in 2016, representing significant progress on our journey towards our goal of driving double-digit operating income.

I'm very pleased with the team's progress to date in 2016. We've delivered solid earnings while continuing to invest in technology to lead our industry's transition to the emerging software-based Cloud architecture. I'll talk more about our strategic customer engagements shortly.

Turning to slides nine and ten, we've provided our consolidated quarterly results year-to-date for 2016 and 2015. So you can see the progress we've made this past year on those slides. If you've turned to slides 11 and 12, we've also included our actual consolidated quarterly results for 2014 to 2016, so you can see our quarterly year - over-year progress.

In summary, while we remain short of our desire for material top line growth, I believe we've made solid progress in all other areas, which now is driving significant non-GAAP profitability and cash flow from operations. Combined with our solid balance sheet, our anticipated cash flow can support additional share repurchases or future opportunities for industry consolidation or some combination of both.

Now I'll shift to the engagements with our largest customers, as well as some new customer opportunities. We've been working with multiple service providers and large enterprise RFPs, as I've mentioned last quarter. These RFPs are being driven by the upcoming change in architecture, or in some cases, also by significant performance issues by established vendors. Our sustained focus on innovation is paying off.

As I mentioned in our July call, I continue to meet frequently with customers and consistently get feedback that our product and software quality is strong, that our roadmap is more competitive than ever, and is fully aligned with our customers' growth strategies. We are now making significant progress in the VoLTE market, and we are underway with a significant North American Tier 1 project to swap their incumbent VoLTE provider with Sonus' SBCs in a portion of their network. This marks our second VoLTE Tier 1 win in North America, and I look forward to sharing more results in VoLTE space in future calls.

Now that we've completed the Taqua acquisition, the strategic feedback from several customers has been quite positive. In fact, we will soon begin the first CLASS Five transformation project for a Tier 1 service provider in North America using the Taqua assets. This is a small project to start, and subject to the successful outcome, this could lead to further revenue growth in 2017. It's early days in that project, and therefore too soon to commit to the timing and size of that incremental revenue until we get further along. We will know more in approximately three months to six months. That said, I find it very encouraging that customers already see the strategic rationale of the Taqua deal. Our technical integration and our cost synergies are ahead of our initial plan as well.

I'll now turn the call over to Susan so she can provide more detail around our financial performance. Susan?

Susan M. Villare

Chief Financial Officer (Interim), Sonus Networks, Inc.

Thanks, Ray. As a reminder, gross margin, operating expense, operating income, net income and loss per share will all be discussed on a non-GAAP basis, have been reconciled for you at the end of today's press release and the presentation. So now let's move back to slide four for a closer look at our third quarter of 2016 non -GAAP financial results. The numbers I'm about to discuss are all related to the consolidated figures, which includes Taqua unless I note otherwise.

Total revenue was $65 million, which was in-line with our guidance. Third quarter product revenue was $38.6 million as compared to $42.2 million in the third quarter of 2015. Total service revenue was up at $26.4 million in the third quarter of 2016, versus $25.6 million in the comparable prior year period.

Our top five customers represented 41% of total revenues for the third quarter of 2016. This compares to 50% in the third quarter of 2015. Third quarter 2016 non-GAAP gross margin was 69.9%, which was relatively consistent with the 70% we reported in the third quarter of last year.

Non-GAAP operating expenses were $39 million, as compared to our guidance of $38.5 million to $39.5 million. Non-GAAP operating expenses decreased by $2.4 million in our third quarter versus a year ago, due to 2015 cost reduction efforts.

Our third quarter of 2016 represents Sonus' fifth consecutive quarter of non-GAAP profitability. Non-GAAP diluted earnings per share for Q3 of 2016 was $0.12, compared to $0.11 in our third quarter last year. Our solid performance was attributable to strong gross margins coupled with our continued cost containment efforts.

I now want to provide some color as it relates to the Taqua acquisition and its impact on our Q3 consolidated financial results. First, we paid approximately $20 million in cash for Taqua on the acquisition closing date, which was September 26. Additionally, we recorded $10 million of contingent consideration, which is our estimate of the earn-out based on current expectations regarding revenue thresholds being achieved as measured annually through 2020.

We plan to finalize the purchase accounting for this acquisition in our fourth quarter. Acquisition related fees of $1 million were recorded in the third quarter. The deal closed the last week of our third quarter, and accordingly, their revenue contribution was modest at $0.1 million. The GAAP and non-GAAP impact of the Taqua acquisition on our third quarter consolidated financial results was a loss per share of $0.01.

Now looking at our balance sheet, it still remains strong. Cash and investments were $121 million at the end of our third quarter of 2016, as compared to $142.7 million we reported at the end of our second quarter of 2016. This sequential cash decline was primarily due to the acquisition of Taqua for $20 million, as I previously noted, coupled with $2.2 million of stock we repurchased under our stock buyback program.

At the end of our third quarter of 2016, we have approximately $7.8 million that remains available under our previously approved stock buyback program. Days sales outstanding were 61 days in the third quarter, as compared to 68 days in the third quarter of 2015.

The last item I would like to cover as it relates to our Q3 financial results is the restructuring initiative that we announced on our second quarter earnings call. At that time, we told you we expected to generate between $6 million to $8 million of savings on an annualized basis and that we would incur between $3 million to $4 million of restructuring expense. We also noted that we plan to utilize these savings to shift head count towards new strategic initiatives for such items as new products, as well as the expansion of our go-to market footprint.

In Q3 of 2016, we recorded restructuring expense of $1.2 million, which resulted in annualized savings of approximately $4 million. The company has reinvested $2.6 million of these savings to date. We believe the program will be substantially complete by the end of our second quarter of 2017.

Now let's turn to slide six and eight, and review our guidance for Q4, as well as our full year. As Ray had previously mentioned, we will provide forward-looking guidance for Sonus, which excludes Taqua, Taqua on a stand-alone basis, and then finally consolidated.

Starting with our fourth quarter 2016 guidance. We expect revenue to be between $65 million and $67 million for Sonus, $1.8 million for Taqua, and $66.8 million to $68.8 million consolidated. Non-GAAP gross margin is projected to be in the range of 69.5% to 70% for Sonus and 68% to 68.5% consolidated.

Non-GAAP operating expenses are expected to be between $39.5 million to $40.5 million for Sonus, and $43 million to $44 million consolidated. Q4 2016 fully diluted non-GAAP earnings per share is expected to be between $0.09 and $0.12 for Sonus and a non-GAAP loss of $0.05 for Taqua. And lastly, $0.04 to $0.07 consolidated. This assumes 50 million of diluted shares outstanding.

Ray provided the factors contributing to our revised outlook for Sonus, excluding Taqua. At this point, I would like to provide some color surrounding why we are lowering the Taqua Q4 2016 revenue forecast now. First, after we further analyzed their wireless business, we concluded that their maintenance does not have the VSOE and thus we will be taking deals ratably over the maintenance period. Our preliminary outlook had a larger portion being recorded upfront.

Second, their Class Five outlook for their fixed products had larger upfront purchases assumed for certain customer projects. It now appears that we will be taking these over time versus upfront.

Third and finally, purchase accounting downward adjustment to deferred revenue was greater than we had originally anticipated. We project the deferred revenue haircut will be substantially complete by the end of Q2 of 2017, at which point their maintenance revenue levels will return to normalized historical levels. Despite the short - term reduction in their revenue, due to the factors previously noted, we still believe the acquisition was strategic and their pipeline remains strong.

Now, let's turn to our full year 2016 outlook. We expect full year revenue to be in the range of $250 million to $252 million for Sonus, $2 million for Taqua, and $252 million to $254 million consolidated. Non-GAAP gross margin is projected to be in the range of 69% to 69.5% for Sonus, as well as 69% to 69.5% consolidated.

Non-GAAP operating expenses are expected to be between $154 million to $155 million for Sonus, and $157.5 million to $158.5 million consolidated. Full year 2016 fully diluted non-GAAP earnings per share is expected to be between $0.33 and $0.36 for Sonus, a non-GAAP loss of $0.06 for Taqua, and lastly, $0.27 to $0.30 consolidated. This assumes again 50 million of diluted shares outstanding.

That concludes our formal remarks. I would like now to turn the call over to the operator for questions. Operator, we are ready for our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question is from the line of Mark Kelleher from D.A. Davidson. Please proceed.

Mark D. Kelleher
Analyst, D. A. Davidson & Co.

Q

Great. Thanks for taking the question. Could you just go over the Taqua revision one more time. I know, Susan, you mentioned three of the issues that were involved there. I'm just wondering when those issues were discovered and maybe why those weren't incorporated in the original guidance?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah, Mark, this is Ray. I'll take a shot at that if you don't mind. That happened between our guide and probably over the last three weeks as we get closer to their revenue issues, take over their G&A functions. The purchase accounting issue is just far more significant impact than we thought. The VSOE (18:46) issue is just things going ratable on the wireless side. They just had worked under private accounting issues and took interpretations that we're just taking a slightly more conservative view on. So that's when that happened. It wouldn't have been included in the prior guidance because we didn't expect it in the prior guidance.

Mark D. Kelleher
Analyst, D. A. Davidson & Co.

Q

Did the – there's a $10 million earn out, right, through 2020 for revenue?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes. That's the valuation of the total capped earn out, yes.

Mark D. Kelleher
Analyst, D. A. Davidson & Co.

Q

And that didn't change at all, right?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

No. The earn out is driven off of revenue levels up through 2020. It's calculated annually. We've carried it – as Susan said, we're carrying it on our books at $10 million. It has the potential to be higher, which would be all in our Q, but we think relative to what our revenue expectations are that's the proper accounting level for it and we'll adjust that going forward if we see it change.

Mark D. Kelleher
Analyst, D. A. Davidson & Co.

Q

Okay. Thanks. I'll get back in the queue.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure. Thanks, Mark.

Operator: Our next question is from the line of Ryan Hutchinson from Guggenheim. Please proceed.

Ryan Hutchinson
Analyst, Guggenheim Securities LLC

Q

Hey, good morning. So a couple of things, Ray. Just given the outlook and as you're looking forward with the pipeline and everything, have you reconsidered maybe some additional cost savings activities as we look forward or maybe some strategic alternatives? So, that will be my first question.

And then, second question is just on the competitive dynamics. You referenced a Tier I win displacing an incumbent, which I think we all know who that is. So I'd just like to get some more color on, one, the timing of that opportunity, potential size, and what were the drivers in terms of the displacement? Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Okay, thanks, Hutch. Will we make additional costs? Yeah, that's actually, the reason we announced the restructuring program is that we are constantly looking at our cost structure. Going back a few years, our OpEx run rates were probably in the range of $20 million higher on an annual basis than they are right now. So I think we've taken a good bit of cost. We'll continue to look at that and we'll balance the cost versus investment equation, but I think our current restructuring program is probably the best lens for you to look through on that as we take about six to eight out and reinvest probably 75% or more, which is why we said we'll invest the majority in. And we are investing in that in some very interesting growth engines, which I t hink are having a material impact on our ability to win business in the current environment.

Second, whether we'll explore strategic alternatives, I'm not going to speak to anything there, but I do believe that we've got a great balance sheet, great cash flow, and we're a great partner. That's what drove Taqua to us, customer interest in a big opportunity in CLASS Five. There's a lot more strategic implications of C5 transformation in the context of an IMS play, and our access SBC, our proxy CSCF was highl y complementary with their IMS lite core that they built and partnered with Ericsson on. So I consider Taqua to be part of the strategic alternative, and there are more beyond that, potentially, and we'll just adjust them as they come up. That's probably as far as I'll go with regard to strategic alternatives, in case there was anything else behind your question.

Regarding Tier 1, yes, the timing of that is we've already started. As to its size, it'll be at least double -digit million dollars over a period of years, potentially in 2017/2018. As to when it scores on revenue recognition, it's a little bit harder to call, so we'll give more color on that next year as we guide to the year. But what I'm very encouraged in in that case, and in other cases of big deals that we're working on is that there's multiple applications that we can go after. This is double-digit millions dollars for years in the future if we can continue to stay close to these big Tier 1s.

Now, as I say that, they're all exploring incredibly creative strategies on where they want and manage or own their data centers, where they're going with regard to content up the stack. You see them buying things. As to how much CapEx they'll still have for their networks – and I just think it's appropriate for us to stay conservative, or what I'd call balanced, because I frankly think there is some risk to our prior guide, and that's why we took it down.

But I'm no less bullish with regard to our strategic options, which is why I'm not going to reduce OpE x just to starve the company into an EPS footprint.

This EPS footprint, I believe, is about the right place for us to be this year in our journey into double digit operating income. We'll generate somewhere in the mid-30%s. I can't remember -- you can just correct me on the exact...

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Yes.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Don't even correct me on the exact numbers, because they're just -- it is what it is. It's in the record. It's our guide. We'll be there. We'll deliver what we said we're going to deliver, but we're also delivering tremendous strategic value to our customers as we help them work through their strategic transitions. And they trust us for that. Okay? I hope that's helpful, Hutch. If not, happy to take a follow up question from you.

Ryan Hutchinson
Analyst, Guggenheim Securities LLC

Q

That's great. I mean, one more, if I could just squeeze it in. Just...

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Please.

Ryan Hutchinson
Analyst, Guggenheim Securities LLC

Q

I know it's still early, but given the AT&T/Time Warner potential merger here, have you had discussions with them and potential for any spending pause or freeze, or anything like that that you see on the horizon?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

So, (A) to be clear, I have not had any discussions with AT&T about their Time Warner acquisition. I believe they're too busy to take my call. But, I will give you my personal color on it. I think it's going to stress their CapEx spend across the board. I would expect that to be the conclusion by the industry analysts, the research analysts on this call and other calls. I think it's the obvious strategy for them to pursue to protect their dividend, to finance that transaction and to explore strategies so that they don't become a dumb pipe.

Now, that said, they're running in it what's hot. We are there to help them, and we're involved in multiple long -term D2 projects, which we're working very, very hard on. And we don't get out ahead of our headlights there, but I believe we're very strategic now to AT&T and will become increasingly strategic. But short-term, I think the entire industry is looking at (A) consolidation strategies, (B) diversification from dumb pipe strategies. You see it certainly in AT&T. You see it in Verizon with regard to their acquisitions. You're starting to see it globally. You see SoftBank acquiring ARM and other aspects of the food chain.

So what we want to do is just stay realistic in our guide, stay strategic in our focus to the big spending search providers, continue to diversify into the enterprise, continue to move to software, continue to drive margins, and where we can, reduce our OpEx so we can deliver financial leverage. But I love the hand we have. It's just a very difficult environment with all the strategic flux, and so my goal today is just to be transparent with you. I hope that's helpful, Hutch.

Ryan Hutchinson
Analyst, Guggenheim Securities LLC

Q

That's great, thank you.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure.

Operator: Our next question is from the line of Jess Lubert from Wells Fargo Securities. Please proceed.

Jess Lubert
Analyst, Wells Fargo Securities LLC

Q

Hi, guys. A couple of questions on the outlook. First, I was hoping you'd provide some additional detail regarding the breadth of the weakness driving the revised forecast, and to what extent we should be thinking about below seasonal trends over the next few quarters.

And then, Ray, perhaps longer term, I was hoping you can give us a sense to what degree you believe your end markets are growing. W hat gives you confidence you can deliver low single digit growth moving forward, given it looks like global carrier spending trends are likely to be down moving forward?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

Q

Great. Thanks, Jess. So, yes, the question on the outlook and the breadth of the weakness, I think it's more of a timing issue than a weakness issue, first of all. And so we're trying to call our outlook properly in Q4, and I think we have.

With regard to end market growth, I do believe that there is some level of consolidation, and likely, if you will, some lumpiness over the next year. It's hard to tell whether that's going to occur Q4 or Q1, so we're j ust trying to prepare for that. But I do believe we're gaining share as well. So when I look at low single digit growth, I look at Sonus consolidated with Taqua, and we'll give more color on our February call, and the consolidation of those two revenue streams will probably drive off of our 2016 results a low to mid single digit growth rate, okay? And I think that with proper expense discipline and margin creates cash flow and earnings, and we'll guide to that next year when we have our February call.

With regard to seasonality, it's too soon for us to call to Q1, but I do think it would be proper for us to tell you that we expect next year to be as seasonal as prior years, and we've always had a low Q1 relative to the rest of the year. I don't see that changing next year, but we haven't done enough analysis to give you any specific facts on that. Okay?

Jess Lubert
Analyst, Wells Fargo Securities LLC

Q

So, Ray, is the assumption that the market you compete in is flat next year?

And then maybe just for Susan, gross margin's been above 69% now for four out of the last five quarters. W ould love to get a sense of what's likely to drive the sequential down-tick in Q4, given it does sound like software's increasing as a percentage of mix.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah, Jess, this is Ray. That's just a mix. We look at our deal flow. We have some that carry a little more third party content than others, some that have a little bit less software density than others, and in part, a mix of deal flow that moved from Q3 to Q4, and some things that moved from Q4 to Q3. We popped a higher margin in Q3 than expected because one of our lower margin deals just deferred into Q4. So that's really all it is. I t hink I would consider that flux, and to the extent that we can beat that guided range by anywhere from 20 basis points to 50 basis points, I think that's somewhere where I'm thinking we'll end up. And I think that what that does is it gives us another 100 basis points to 150 basis points of progress year-over-year, and then when we have our February call, we'll try to give you an indication as to whether or not we can make that progress again next year. Okay? I hope that's helpful.

Jess Lubert
Analyst, Wells Fargo Securities LLC

Q

All right, thanks.

Operator: Our next question is from the line of Greg Mesniaeff from Drexel Hamilton. Please proceed.

Greg Mesniaeff
Analyst, Drexel Hamilton LLC

Q

Yes, thank you. Ray, I was wondering if you can give us a little more color on the potential for customer synergies with Taqua. In other words, what do they bring to the table as far as their customer base? And where, are there opportunities to cross sell your existing products with theirs? Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure, Greg. Thanks for that question. So actually, it's quite exciting. It's not yet in our guide. I just want you to know I don't have some hockey stick in 2017 for any of these material opportunities, but I'll try to go through them in order. And I'll start with the more mundane CLASS Five transformation. Some of these offices are many decades old. You'd be surprised what you see when you walk into them, and they come with a ver y solid classified softswitch opportunity, which is very nicely tied to an IMS core strategy which lacked in SBC, and it lacked a policy engine.

So we're already seeing interest in a pull through. That's actually what drove the transaction. We saw a lot of interest in pull through for our SBC and for our policy engine in a number of their existing customers. Now, mind you, they had success in Tier 2, Tier 3, so a lot of these names may not be names you recognize or names you'd write on, but they're material drivers to their revenue stream, and they'll probably be sustainable through this transaction. W hat we can do is upgrade that to a Tier 1 presence because we have the credit, we have the embedded nature of our CLASS Four.

Now, right now, the opportunity in North America with the Tier 1 is a Taqua-only strategy. It doesn't connect to our deeply embedded CLASS Four assets in that carrier. But we're actually exploring ways to do that in the second breadth, which would develop into a pretty pervasive IMS play. These companies have already taken down one slug of IMS, generally speaking, from the big guys like Ericsson, Huawei, Alcatel -Lucent and Nokia, and they have incredibly small traffic on it. Because they're very heavy duty, they are not transitionable to an NFV strategy. Most of them are stuck in a hardware architecture, and so they're kind of looking at alternatives with – having already spent some money on IMS, they're reluctant to do it again, but they're looking at a way to help us get them into a future architecture. So that's one. I'd call it classified transformation that could evolve into a much more end to end strategy.

Two is a mobility play. They've already got multi-tens of millions of dollars of established software-based client assets on femtocells with a couple of carriers around the world, some of which are Tier 1s in North America. That has stalled in recent years and we think we can resurrect some of that depending on how we can tie that to a more broad strategy. So, it has a nice maintenance coupon to it. It's got a small amount of attached to it from the standpoint of their existing projects, but we could certainly turn that into a viable revenue stream with some very nice current customers.

They also have a Voice over WiFi client, which together with a Voice over LTE client we could pull through to our policy engine and SBC and create a fixed mobile conversion switch. I've alway s believed it is where the industry's going. It's probably been anticipated for 30 years, but I do believe now that LTE is pervasive, Voice over the data channel, Voice over WiFi and Voice over 3G are going to become client options and people are going to start to explore that strategy. That's going to be attractive to anybody without spectrum, which includes Tier 2s, Tier 3s, and the cable industry. And frankly, I think it's going to be attractive even to the folks with spectrum as a data offload and a voice offload strategy.

So those are a couple of them, Greg. I hope that's enough. We've got some additional home run strategies that I just won't take to you at this time because we need to explore them. But I'm very pleased that we've done this acquisition. I think we can block and tackle off their current revenue stream. I think we can drive additional synergies beyond what is anticipated, especially given this fourth quarter miss, we're going to go back and look at additional strategies to address this before what we were planning to do on January 1. And we'll keep you posted on that on our next call. Did you have any additional questions, Greg?

Greg Mesniaeff
Analyst, Drexel Hamilton LLC

Q

Thanks for – yeah, thanks for that color, Ray. Just a quick fol low on. Did you break out your percentage of revenues from enterprise? And if you did not, if you can just give us some color on that? And also, if you're looking at all to move a little bit downstream as far as smaller enterprise customers? Thanks.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yes, we did, Greg, in my prepared remarks we showed. It's in the slides. It's 21% of product revenue went to the enterprise, okay?

Greg Mesniaeff
Analyst, Drexel Hamilton LLC

Q

Got it. Next...

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

And whether or not we'll go down market, I would say we're already down market. Our enterprise strategy is both – we do direct sell to the large enterprise and hand it off to the channel whether that channel is a service provider or a VAR. And we've always had a vibrant channel in the link now Skype for Business market, as well as in the VAR channel where our 1K, 2K sells what I would call downm arket where the session densities might be 50 to 1,000 sessions. So we're already there and we'll continue to focus on that. We're doing a lot of work in the Microsoft environment, moving our 1K, 2K to be more compliant with their strategic goals in Azure and we'll talk more about that as we do product releases in the fourth quarter.

Greg Mesniaeff
Analyst, Drexel Hamilton LLC

Q

Thanks, Ray.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure. Thanks for your question.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Thanks.

Operator: Our next question is from the line of Paul Silverstein from Cowen and Company. Please proceed.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Thanks, guys. I just have some clarifications. If you already gave this, my apologies. We can take it off line. First off, Ray, can you give us any insight on new customers in terms of number and what percent of revenue?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Susan, will give you the new customer number in a second here, Paul, but it was over 100, wasn't it?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Yeah, new customers is 145 this quarter.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

How many of those were service providers, Susan?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

We don't break that out.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

I would say it was a handful.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Yeah.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

It's a small number. A lot of it is channel and enterprise, but we have brought on a handful of new service providers.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Can you tell us what they were as a percent of revenue? New customers?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

I'm sorry, Paul?

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Can you tell us what they were as a percent of...

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

The new customers, what they were?

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

As a percent of revenue...

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

We don't break that out.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

All right.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Yeah. Let me see if we can get our arms around that, Paul, if we can. Yeah, we will disclose that.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.
A

Going forward, perhaps.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Yeah, going forward. We'll try to get our arms around that. But it's a relatively small percentage of revenue.

Paul Silverstein
Analyst, Cowen and Company, LLC
Q

All right, I appreciate it. And I forget, do you guys provide book to bill?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

We generally don't, but I will tell you our book to bill was above 1, and over the last six quarters we've consistently been on average above 1.

Paul Silverstein
Analyst, Cowen and Company, LLC
Q

Okay. And on the calendar 2017 low single digit revenue guidance, was that organic or was that including Taqua?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Say that question again, Paul, please.

Paul Silverstein
Analyst, Cowen and Company, LLC
Q

I thought I heard you say that for calendar 2017, Ray, you're expecting low single-digit revenue growth. Did I hear that correctly?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Yeah, and that would be consolidated.

Paul Silverstein
Analyst, Cowen and Company, LLC
Q

Consolidated? So that's with the benefit of Taqua?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.
A

Yes.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Okay. And can you-- did you discuss linearity in the quarter?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

I didn't yet, but I'm happy to. Our linearity was pretty good. Our DSOs were 61 days? 62 days?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Yep.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

So I felt good about our linearity. We've had actually good linearity throughout the calendar year, and I expect decent linearity this quarter as well, Paul.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Okay.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

So I'm pleased with that. Happy to discuss that further if you've got a follow-up question.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

All right. Just two other quick ones, if I may, a little bit more expansive. Ray, with respect to your comments on enterprise a moment ago, if I recall, when you acquired NET back when you had a lot of momentum in the enterprise, and it worked out very well for a while, and then I thought there was a reversal or a deemphasis on the enterprise piece. And today I hear you saying -- is it that you're refocusing on enterprise? Is there a change in strategy? Is there something new and different? Or is it just waxing and waning in the business? And then I've got one last quick one, if I may.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Absolutely, Paul. So there's never been a change in the enterprise strategy. There is flux in our results. We are very strong in the service provider, and so we're not going to abandon that for some home run strategy in the enterprise. And then I've also said on prior calls, I'm happy to restate, that I believe at the end of the day, which may be two years, three years from now, there's a convergence in the enterprise and the service provider, because frankly, the service providers are probably going to defer to the big data center players, at least in collaboration, as public, private, hosted Cloud with, say, Amazon and Google and others. Then they're going to move a lot of their call control to the Cloud, and what the enterprise is or isn't is going to evolve. So, I actually believe it will become more of a unified market. And we're pushing very hard on both.

And the products that tend to be focused more service provider centric, even though they actually play in the enterprise, especially the large ones like the banks, are the 7K and the 5K. And of course the 9K is still our workhorse, because it's so deeply embedded that a lot of people are buying the SBC as a 9K just because they're so familiar with the user interface. And the 1K, 2K and our SWe are the principal ways – software edition I'm talking about when I say SWe, by the way. Those are our principal go-to market strategies at the enterprise. But now, the enterprise is often a combination of a headquarters, which tends to be heavy duty 5K, 7K, or a call center, which tends to be a 5K, 7K, and a lot of edge offices, which tends to be a 1K, 2K. And once you get there, it's just a viable branch exchange. It's got TDM. It's great.

And we're involved in the link environment and the Skype for Business environment, and I'm personally, along with our leadership team, very, very involved in the long-term design structure of the Azure Cloud with some folks in Redmond and throughout Microsoft, because they're evolving very, very quickly. I think they sense a ton of pressure from Google and Amazon. It used to be Google and Amazon. I think it's now Amazon and Google. And we're involved in Amazon and Google with regard to the evolution of their Cloud strategies, which up-to-date has been best effort Cloud strategies, and they're evolving very quickly to embrace the SLA requirements of the telcos.

So, I'm extremely excited, have been for a long time, about the enterprise. It's just, it is a long sales cycle. It does generate lumpy results, and from time to time, it drops into the teens and then it then pops up into the 20%s. And if that's given any appearance of a shift in strategy toward them or away from them over the last year and a half, it's my bad. I'll just clarify it on this call: we remain 100% focused on the enterprise.

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

Okay. And my apologies, my peers on the call, but if I may, one last question. And Ray, I'm going to apologize. I recognize this maybe a controversial way I'm going to frame it, but given the Treq acquisition, which appeared to have a lot of momentum in next generation product line at the time. And I don't think we've heard anything about it recently, so I'm assuming that – maybe it's going better, but I'm assuming it hasn't, or maybe you've just been quiet about it. But given that Treq doesn't seem to have panned out in spite of the promise, and the momentum they had at the time of the acquisition. Given that Taqua's been around for a long time, I think that c ompany is now 18 years old and you're the third company to now have acquired it in that time span, are there lessons learned? And why – I guess I don't understand the optimism in -- are there lessons learned from Treq and other acquisitions that you've done in terms of looking at Taqua going forward?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Hey, Paul. It's a great question, and I'm glad you asked it, so please feel comfortable because I don't think you need to apologize at all for the question. It's something that I think about all the time, and we talk about as a leadership team.

(A), one, I want to just point out a few things. We did an upfront cash payment and an earn -out in both of those transactions. I'm convinced that both of those transactions made sense at the time and still make sense. Okay? Now, the question is, did they generate the revenue hockey stick that was associated with the earn -out? In the first case, it clearly hasn't, and we disclosed what we thought would be a fair market value for the earn-out. It hasn't happened. I'll be glad to explain for you in a second why. I'll give you some color.

We structured Taqua the same way with a modest upfront payment, which allowed them to resolve the credit facility they had. We took the company on clean. We cleaned up a lot of their payable issues and what have you. And we got really good technology.

Let me go back to Treq, and then I'll come back to Taqua, okay? But I just wanted to lay out the structure of our thinking so that you could understand why we think it was a smart thing to do. Based on an upfront payment at Treq, we got some great SD wan in (41:03) assets and we got a layer-two switch and a number of other assets and a team.

The layer-two switch market is a commodity market, and trying to layer our technology on top of third-party layer-two switches became a bigger challenge for us than frankly we were up to, based on our footprint in the enterprise. But it's still a great technology play for us to blend with our signaling policy and SBC assets to create a new software stack in the Cloud. So I'm glad we did that. But the reason we don't talk about it is it's not material to our results from a revenue point of view yet. Okay? But that's how I look at it, so I'll just offer that to you the same way you offered the question, and hopefully that's responsive.

But the lesson learned is, should you pay for that hockey stick, or should you put that burden back on the company that you acquired to deliver what they say they're going to do at the time of the transaction? We've done the same thing with Taqua. We set revenue goals that they thought they could hit. I believe that we can properly discount those, which is why we're carrying that earn-out of $10 million as an NPV fair market value after the analysis is done. They have an opportunity to earn-out more than that. Our current outlook doesn't drive that at all. It doesn't drive it in 2017. It probably wouldn't drive it in 2018, although we haven't really guided anything there
or worked that model. But what it does give us is incredibly strong classified assets, which I do believe is a vibrant market for network transformation. We had validated that before the transaction. I personally validated that with a few Tier 1s since.

It gives us an opportunity to hunt in that market, ties to our CLASS Four, which nobody else can do, ties to IMS lite, which few people can do, and see if we can generate some revenue off of that, in which case this will be a very high margin business. But for the professional services side of the business, which could or could not create a margin drag at the onset. It also gives us a good Voice over WiFi VoLTE synergy play, which comes as a coupon. It gives us some massive footprint in Sprint at the femto level that we can monetize with additional end to end. And given our SoftBank presence in Japan and our relationships there at the network level, it allows us to think globally about SoftBank where we haven't been able to do that before.

So Paul, I'm optimistic on it. But at the same time, I want to tell you that my optimism is tempered by the fact that we're only going to guide a conservative outlook for Taqua, and the burden is on them and their earn -out to deliver that. And if they deliver their earn-out and get it, it'll be accretive to Sonus. All right? So that's how we're structuring those, and if it looks like a tired asset that's been around for 20 years and changed hands, it is. There are others out there like that, and the question is, what do you do when customers ask you to please help them through their transactions? And so that's how we're thinking about it. I hope that gives you a transparent view, and now what we need to do is go out and deliver that in 2017. Okay?

Paul Silverstein
Analyst, Cowen and Company, LLC

Q

I appreciate the response. And I'll pass it on.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Sure. Thanks, Paul. Next question?

Operator: Our next question is from the line of Mike Latimore from Northland Capital. Please proceed.

Q

Yeah, hi. This is [ph] Vijay Devar (44:01) for Mike Latimore. Thanks for taking my question. Commentary around the timing of certain deals, do you quantify the revenue impact?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Could you say that again, [ph] Vijay (44:15)? The timing of what?

Q

The certain deals that impacted or triggered the lower revenue growth. Did you guys quantify the revenue impact?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Is this for the Taqua acquisition you're asking?

Q

Yeah.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

[ph] Vijay (44:32), I'm sorry. I don't understand your question. The certainty of – are you talking about the Sonus - only guide that was in the mid-70%s to the 65% to 67%? Is that your question?

Q

Yeah, for the fourth quarter guidance. Yeah.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Okay. So I think I understand your question, [ph] Vijay (44:45), that it is what was it that drove the magnitude of that? As I said in my prepared remarks, we have a number of customers that are going through either consolidation or M&A that I just personally believe could cause some push in their current projects, and so we've tried to reset those around that current push and I actually believe that's what is going to happen, so that's why we shifted our guidance. It's not just a hedge.

And with regard to other projects that personally either literally the exact sponsor of or directly involved with other executives on the other side, I just believe any where between the acceptance, or the [ph] Viso (45:25) issues, or the third party risks associated with other folks that are involved in the plans, it's just proper to repay some of the revenue recognition around those big projects. But I'm, at the same time, very excited about what this exposes us to with regard to Tier 1 VoLTE, both for interconnect and then follow-on access opportunities, and then ultimately end to end opportunities on these big companies. This is a different place for us to be hunting in Tier 1 to North America, almost across the board. And so what I – that's what's driving that delta $9 million or somewhere in the $9 million at midpoint. Okay?

Q

Okay. So does it mean for the first quarter next year we will see slightly different from the regular seasonality?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

No. W hat I said I think in response to a question by Jess Lubert is we do continue to expect seasonality in 2017. I would expect our first quarter to be our weakest quarter, which it's been for the majority of my watch over the last six years. But, when we look at the year in the aggregate, with regard to – like our calendar 2016 revenue was likely to be a one and done not repeat, and then what's likely to come in net new, we consider that to be basically a wash. And as a result, we consider Sonus to be flat and Taqua to add a modest single -digit growth to our total top line. But the Q1 seasonality issue is not going to be offset by a dramatic push out of Q4, which is going to spike Q1. I would not suggest that you model it that way.

Q

Okay. If I may squeeze in one more. On the revenue recognition side, is it more only on the revenue impact or will it impact even the cash generation which was expected early on?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

No. I mean, we'll get the cash up front. We just can't get – score the revenue upfront. It will be ratable.

Q

Okay. So the cash remains the same, I mean, in terms of the cash generation remains the same?

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Yes, that's correct.

Q

Okay. Yeah, thank you.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Great. And I think that's our last question?

Operator: Our next question...

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Or we have one more? Okay, great.

Operator: We do. Our final question is from the line of [ph] Steve Cohen from Provo Partners (47:32). Please proceed.

Q

Hi, thanks for squeezing me in. Three questions. First, the $7 million spike in accounts receivable in the third quarter, if you could give us some color on that. Second question is the fourth quarter revenue guide downward. Is that [indiscernible] (47:50) fall off of the legacy business, slower growth of the growth products? Some color on that.

And then just more strategically, Ray, kind of what needs to happen to get out of the $65 m illion plus or minus per quarter revenue? Is that broadening of the product line? Enhancing of the distribution capabilities? Kind of what's it going to take for Sonus to break out of that plateau?

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah, [ph] Steve (48:17). I'll ask Susan to just deal with the AR issue, and then I'll come back to you on the mix of our guide down and the $65 million range bound question. Yeah, go ahead, Susan.

Susan M. Villare
Chief Financial Officer (Interim), Sonus Networks, Inc.

A

Okay. Yes, so as we said, our DSOs were up 61 days, which is consistent with last year. It was actually up last year at 68 days. So we had unseasonably low AR, I believe in the first half. So, typically we are around the 42 to 46 mark. So we expect that to continue next quarter, to similar DSOs, so that we have no bad debt and no issues with collections.

Raymond P. Dolan
President, Chief Executive Officer & Director, Sonus Networks, Inc.

A

Yeah. So, Steve, I – thanks, Susan, for clarifying that. I do believe we've probably regressed back to more normal. I call DSOs substantially higher than this as a business under stress, but right now we're in good shape.

With regard to the Q4 guide, it probably is a little bit more growth related because it's a timing issue and those are big deals related to a couple of those customers that are going through those changes as I described in my prepared remarks. So, to the extent that it led to a smaller piece of growt h revenue in Q4 but deferred it into 2017 that's probably the more likely case. I don't believe that's unhealthy, but at the same time, to the extent folks want to opine on that in their research, they're welcome to do so.

With regard to the $65 million range bound question, yeah, you're right, the math looks like we're going $65 million to $65 million. We've had prior Q4 substantially higher. It is $65 million to $67 million. We'll see where we actually end up. W hat will it require? It will definitely require us to continue our drive to new customers and we're doing that, most of which are small to medium-sized enterprise and a small handful are service providers, but we've always had a strong service provider business. It requires us to continue to move beyond the Internet – I'm sorry, the interconnect app in these big service providers and move out to access and we're doing that. It requires us to leverage Taqua, which I think we will do next year. I'm going to get personally involved. I've been personall y involved in a number of Tier 1 discussions around that, which is what drove the transaction in the first place and I'll remain involved.

And then, we really need to broaden our reach into the Cloud players. I think in order for us to be really strategically successful, we've got to be even more strategic to Microsoft, which we are, but I think by that I mean, at the end of a SIP trunk, it's us and audio codes. We share that market, it's like parts is parts. Most of the end market considers it undifferentiated, I'll just be clear about that. So you go out and try to sell, it's basically just either pricing or an after-sale support and we're strong in Europe. They're strong in some parts of Asia Pac. We're both strong in North America. So, what we need to do is change that game. We need to become very strategic to the go-to market strategy of Azure and we're working very hard on that.

We need to continue to expand in the cable MSO space. And we are, but they're going under a lot of pressure, they're consolidating. They're reorganizing, literally as we speak. And so, I just want to be clear, when we guide to the market we're going to guide what we think we can control. We're going to guide to the ranges of outcomes to questions on people's call before. Meantime, we'll continue to drive synergies, both with Taqua as well as in our own organization. We'll probably put three quarters of that back into growth initiatives and about a quarter of it to the bottom line through our restructuring program and we'll hit our EPS.

So, [ph] Steve (51:42), what I come back to your question to just offer a closing remark that's triggered by your question, if you don't mind, it's what I put in my prepared remarks. We're still missing growth. We're missing material growth. I would consider the company flat because even if we did 1% it's flat, okay? So, I'm not going to argue with the marketplace's perception that Sonus is flat. We're continuing to retool from legacy to growth. Growth is just enough to absorb the downturn in legacy. We think that will continue for another year, roughly. Taqua will bolt-on some inorganic revenue. I'm not going to hide that in some mixed consolidated results. And what we need to do is just continue to be faithful to our customers as they mak e this turn, and when they do, we're going to be there with product that gets them into market with an affordable simple solution to go to the Cloud. And that's the part that I'm excited about.

And meanwhile, we've now taken a company that was largely in the high 50%s, even though it would spike at 62% and then report a 50% number, we have now reliably marched through the 60%s and we should end this year touching 70%, maybe even for the full year we'll see. All right?

And then we'll guide the next year, and those 12 points have now gotten to the bottom line at least to the point where we're at 7% to 8%. And what we'll try to do is expand that EPS and become an EPS growth story next year without a lot of top line growth, and then the world can judge what that's worth. Solid balance sheet, solid cash flow, solid EPS growing at a reasonable rate, and the world can put a multiple on that and we'll just get back to work. All right?

Raymond P. Dolan

President, Chief Executive Officer & Director, Sonus Networks, Inc.

So, [ph] Steve (53:09), thanks for your question, I hope I've answered it. And thanks to everybody on this call for their continued interest in Sonus, regardless of how you see us. W hat you see is, I believe, a really solid team of 1100 people working very hard for a number of service providers that are trying to figure out where they're going to go from here. And we're going to get back to work now. Look forward to meeting many of you in the marketplace on either non deal road shows, or frankly, in just one-on-one coverage discussions. Okay. Have a great day, guys.

Susan M. Villare

Chief Financial Officer (Interim), Sonus Networks, Inc.

Thank you.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines. Thank you.